Franchise Tax Board

ANALYSIS OF ORIGINAL BILL

Author:	Ackerman	Analyst:	Jeani Brent	Bill Number:	AB 1843
Related Bills:	See Legislative History	Telephone:	845-3410	Introduced Date:	02/07/2000
		Attorney:	Patrick Kusiak	Sponsor:	Franchise Tax Board

SUBJECT: Eliminate Reference to "Income Year" in the Income Tax Law

SUMMARY

This bill, sponsored by the Franchise Tax Board, would replace the references to "income year" with "taxable year" in all provisions of the Bank and Corporation Tax Law (B&CTL), the Administration of the Franchise and Income Tax Laws (AFITL), and the Personal Income Tax Law (PITL).

EFFECTIVE DATE

This bill specifies that its provisions would apply to taxable years beginning on or after January 1, 2000.

LEGISLATIVE HISTORY

AB 10 (Stats. 1999, Ch. 64) eliminated the minimum franchise tax for the first two taxable years for all corporations first incorporated or first qualified to do business on or after January 1, 2000.

PROGRAM HISTORY/BACKGROUND

California's Bank and Corporation Franchise Tax Act, enacted in 1929, imposed a franchise tax on every corporation and bank doing business within the limits of the state, unless specifically exempt. The franchise tax is imposed for the privilege of exercising the corporate franchise in this state. The Franchise Tax Act implemented the provisions of Section 16 of Article XIII of the California Constitution, enacted in 1928, that authorized a state tax on banks according to or measured by net income in lieu of all other state and local taxes, except taxes on real property. This provision was adopted in response to federal legislation enacted in 1926 that authorized four permissible forms of state taxation on national banks. The corporate income tax, enacted in 1937, imposes a tax on the net income of every bank and corporation that derives income from sources within California but that is not doing business in California. The corporate income tax is an alternative to the franchise tax and applies only in limited circumstances.

When originally enacted in 1929, the corporate franchise tax imposed on a corporation for the corporation's first and second taxable years was measured by the corporation's net income received during its first year of business. The tax is measured by the net income of the preceding year, which is referred to as the "income year." The year for which the tax is paid is known as the "taxable year."

Board Position:			Department Director	Date
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The use of the amount of income earned during the first “income period” to determine the amount of a corporation’s franchise tax during its first two “taxable years” was eliminated in 1970. The law was changed so that the franchise tax for a corporation’s first “taxable year” is simply equal to the minimum franchise tax.

SPECIFIC FINDINGS

Under existing federal law, corporations generally are taxed based on their taxable income computed using the separate tax accounting model. A corporation’s taxable income for federal purposes generally equals its gross income less deductions for the taxable year.

Under existing state law, the franchise tax is imposed for the privilege of exercising the corporate franchise in this state and is measured by the income of the corporation from California sources in the prior year. The period for which the income is measured is called the “income year” and the period for which the tax is paid is the “taxable year.”

Until recently, when a corporation incorporated, qualified to transact business, or began doing business in the state, the franchise tax for its first taxable year was the prepaid minimum franchise tax. Corporations that first incorporate or first qualify to do business on or after January 1, 2000, no longer are required to pay the minimum franchise tax for the first two taxable years.

A corporation’s income for the first year serves as the measure of the tax for the second taxable year, and the income of each succeeding year serves as the measure of tax for the next following year. Thus, the franchise tax is on a prepaid basis; the income year precedes the taxable year of the corporation by one year.

Distinguished from the franchise tax, the corporate income tax is imposed on income from California sources in the year received or accrued. Thus, for corporate income tax purposes, the period of the income year and the period of the taxable year coincide. The corporate income tax is an alternative to the franchise tax and applies only in limited circumstances where a corporation is not doing business in this state during the taxable year.

This bill, sponsored by the Franchise Tax Board, would replace the references to "income year" with "taxable year" in all provisions of the B&CTL, the AFITL, and the PITL. To the extent a provision refers to a tax measurement period beginning prior to the operative date of this bill, the term "taxable year" would mean "income year" under prior law wherever applicable.

This bill would specify that the franchise tax, like the income tax, would be computed based on the net income for the taxable year, instead of based on the net income of the next preceding income year. This bill would include legislative declaratory language that the sole purpose of the change is to simplify the law and that the actual amount of tax required to be paid and the timing of the payment will not change as a result of this bill. Further, this bill would state that if a taxpayer can demonstrate that it was required to accelerate any payment of tax as a result of this bill, the department shall adjust the amount and due date of each payment of tax to the amount and due date that would have been required under the law prior to the enactment of the bill.

This bill would amend the provision that exempts new corporations from payment of the minimum franchise tax at the time of incorporation and for its first year. Since this bill changes the measure of the tax from the “income year” to the “taxable year,” it is necessary also to amend current law to refer only to the first taxable year, rather than the first and second taxable years. Without this change, the bill would result in extending the exemption to the second tax return (formerly the third taxable year). See the attached Table 1.

Policy Considerations

The use in California corporate tax law of the terms “taxable year” and “income year” makes California tax law unnecessarily complex. Neither federal tax law nor the tax law of other states uses an “income year” concept. This difference between California law and the laws of the federal tax system and other states can be confusing for taxpayers.

This complexity no longer is justifiable. The elimination of the "doubling up" in 1970 and the recent elimination of the prepayment of the minimum franchise tax for the first and second taxable years have eliminated the need for this complexity.

Implementation Considerations

Implementing this bill would require the department to change the references to income year to taxable year in the forms and instructions and make appropriate changes to the department’s systems. In addition, the department would need to ensure that taxpayers are made aware of the change. These changes could be made during the normal annual update.

FISCAL IMPACT

Departmental Costs

This bill would not significantly impact the department’s costs.

Tax Revenue Estimate

This bill would have no identifiable revenue impact on the state’s income tax revenue.

BOARD POSITION

Support.

The Franchise Tax Board voted at its December 16, 1999, meeting to sponsor the language contained in this bill.

AB 1843
Table 1

Description	**Prior Law**	**AB 10 (Stats. 1999, Ch. 3)**	**AB 1843**
Taxpayer incorporates 1/2/00	$800	0	0
Est. Payment for 1st income measurement period (4/15/00)	$800	0	0
T/P files return for 1st income measurement period(3/15/01)	0	0	0
Est. Payment for 2nd income measurement period (4/15/01)	$800	$800*	$800**
T/P files return for 2nd income measurement period(3/15/02)	0	0	0

* 2nd Income Year – 3rd Taxable Year

** 2nd Income Year – 2nd Taxable Year (proposed law change to make income years and taxable years the same)

NOTE: The $800 minimum tax applies only if the taxpayer’s measured tax is less than $800.